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Yanukovych and gas price capping

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A failure to change the price capping policies should warn against returning the Yanukovych government to office after the pre-term parliamentary elections

In May 2005, when the Yulia Tymoshenko government introduced limited and temporary price caps on oil, President Viktor Yushchenko threatened to remove her from office. Western observers also quickly jumped on the bandwagon and used price capping and re-privatization as two sticks with which to beat the Tymoshenko government.

The result has been that in some business circles and among foreign investors the enduring memory of the 2005 Tymoshenko government is price capping and support for mass re-privatization. Both memories are taken out of context and are merely used by the same group of critics of Tymoshenko who refer to her negatively as 'populist' (see "Whose 'populist' in Ukrainian politics," Kyiv Post, July 5).

Why then the deafening silence over the price capping on a far greater scale of gas prices by the Viktor Yanukovych government?

Prime Minister Yanukovych told his government on July 18 that 'his government would never undertake populism.' In reality, the bans on export of grain and gas price controls are two big examples of populist price controls introduced by the Yanukovych government to win votes.

On Dec. 19 of last year, the Anti-Crisis parliamentary coalition adopted the 2007 state budget. Article 3 of the budget law states that all enterprises with state ownership of more than 50 percent, as well as joint ventures and Joint Activity Agreements (JAAs) concluded with these enterprises must sell their monthly production to a company specified by the government.

In a Jan. 16 government resolution (No. 31), Naftogaz Ukrainy was named as the company authorized by the government. Naftogaz became de facto the only company authorized to buy gas from JAAs and then sell it on to the Ukrainian population. The aim of these policies introduced by the Yanukovych government is to control the price of gas for the population on a scale far greater than temporary oil caps in 2005. The difference between the historic selling price of gas in Ukraine to industrial end-users at market prices of $4.88 mcf (1,000 cubic feet) and the fixed government price of $1.63 is more than 300 percent.

Many Western companies have opted to therefore halt all sales of gas rather than sell at a capped unprofitable price. The new capped price does not cover the costs of exploration, development and production, leading to lower production and investment. Cardinal Resources, a public limited company traded in London with a US subsidiary, Carpatsky Petroluem, is one of a number of Western companies which have halted all gas sales and instead placed their gas into storage.

The Yanukovych government policies have two negative outcomes.

Firstly, foreign investors, such as Cardinal, have an adverse cash flow because they cannot sell gas at market prices. To agree to sell their gas at the capped price to Naftogaz Ukrainy would be to sell it at a loss.

Secondly, Cardinal, as with other foreign investors, sees the government's price capping policy as particularly having a negative effect on foreign investors. Price capping reduces the incentive for foreign investors to come to Ukraine at a time when only 28 percent of Ukraine's gas demand is met by domestic production.

Government price capping of gas directly contradicts Ukrainian legislation, such as the Civil Code and the Law on Foreign Investment. In April, Europa Oil and Gas (Holdings) plc won their case in court of the right to sell gas at market prices but the government continues to ignore the court ruling. This is not the only evidence of a non-listening government. Cardinal Resources sent letters on the gas price capping policy to Prime Minister Yanukovych last December, to Minister for Fuel and Energy Yuriy Boyko in March and to the CEO of Naftogaz Ukrainy in May.

Cardinal Resources failed to receive responses to two of the letters and only a curt and non-committal reply from the Deputy Minister for Fuel and Energy. A March letter from US Ambassador William Taylor to Minister Boyko also failed to receive any response. Two meetings between Boyko and Cardinal Resources produced no results.

A July paper published by the prestigious Washington think tank, the Center for Strategic and International Studies (CSIS), described how it was 'extremely difficult' for Western energy companies to obtain a foothold in the Ukrainian market. Western investors have the potential to make Ukraine independent in its energy needs, thereby making Ukraine free of Russia's monopolist and corrupt energy relationship.

It has long been evident though that a large proportion of the Ukrainian elites wish to maintain the status quo because they receive large rents from the existing corrupt energy relationship with Russia. Energy corruption therefore overrides Ukraine's national interest and the country's national security.

According to Ambassador Keith Smith, author of the CSIS report, a major factor blocking Western investment in the energy sector is 'control of natural resources by groups hostile to Western investors.' The Yanukovych government is effectively squeezing Western investors out of Ukraine, Ambassador Smith concludes. The two groups which benefit from these price capping policies are the corrupt intermediary RosUkrEnergo, which, according to a Radio Free Europe/Radio Liberty report, is the biggest money laundering operation in Europe, and local oligarchs. Only one political force – the Tymoshenko bloc – has consistently opposed the use of RosUkrEnergo as a middle man.

The Ukrainian population meanwhile suffers while Western investors pause, or withdraw. Desperately needed foreign direct investment (FDI) and technologies are directed toward governments that show themselves amenable to international standards of economic behavior.

The Yanukovych government's policy puts into question its stated desire to join the WTO, establish a free trade zone with the EU and eventually join the EU. Price capping also puts into doubt the government's declared interest in attracting foreign investors and its stated desire for energy security and independence. These policies are far more populist than anything introduced in 2005. The unwillingness of the Yanukovych government to respond to the concerns of foreign investor, or to have any common courtesy in responding to the US Ambassador, necessitates a stronger response from the US government, EU and WTO. A demarche should point out that the Ukrainian government's price capping policy is inconsistent with international norms on attracting foreign investment, attaining WTO standards consistent with membership and the Ukrainian government's statements on seeking energy self-sufficiency.

A failure to change the price capping policies should warn against returning the Yanukovych government to office after the Sept. 30 pre-term parliamentary elections. Ukraine's post-election new government should be committed to three policies: attracting foreign investment, battling corruption and energy independence. The Yanukovych government has proven that it has no commitment to any of these three policies.

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